



# Report and Recommendation of the President to the Board of Directors

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Project Number: 47314  
November 2014

## Proposed Policy-Based Grant Republic of Kiribati: Strengthening Fiscal Stability Program

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Asian Development Bank

## CURRENCY EQUIVALENTS

(as of 22 October 2014)

Currency unit	–	Australian dollar/s (A\$)
A\$1.00	=	\$0.8779
\$1.00	=	A\$1.139

## ABBREVIATIONS

ADB	–	Asian Development Bank
CSO	–	community service obligation
GDP	–	gross domestic product
IMF	–	International Monetary Fund
KDP	–	Kiribati Development Plan
KERP	–	Kiribati Economic Reform Plan
MFED	–	Ministry of Finance and Economic Development
PFM	–	public financial management
PVU	–	Plant and Vehicle Unit
RERF	–	Revenue Equalization Reserve Fund
SFSP	–	Strengthening Fiscal Stability Program
SOE	–	state-owned enterprise
TA	–	technical assistance
VAT	–	value-added tax

## NOTE

In this report, "\$" refers to US dollars, unless otherwise stated.

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## PROGRAM AT A GLANCE

<b>1. Basic Data</b>		<b>Project Number: 47314-001</b>	
<b>Project Name</b>	Strengthening Fiscal Stability Program	<b>Department /Division</b>	PARD/SPSO
<b>Country Borrower</b>	Kiribati Kiribati	<b>Executing Agency</b>	Ministry of Finance and Economic Development
<b>2. Sector</b>	<b>Subsector(s)</b>	<b>ADB Financing (\$ million)</b>	
✓ <b>Public sector management</b>	Public expenditure and fiscal management		1.00
	Reforms of state owned enterprises		2.00
		<b>Total</b>	<b>3.00</b>
<b>3. Strategic Agenda</b>	<b>Subcomponents</b>	<b>Climate Change Information</b>	
Inclusive economic growth (IEG)	Pillar 1: Economic opportunities, including jobs, created and expanded	Climate Change impact on the Project	Low
<b>4. Drivers of Change</b>	<b>Components</b>	<b>Gender Equity and Mainstreaming</b>	
Governance and capacity development (GCD)	Institutional development	No gender elements (NGE)	✓
Partnerships (PAR)	Public financial governance Implementation		
Private sector development (PSD)	Regional organizations Public sector goods and services essential for private sector development		
<b>5. Poverty Targeting</b>		<b>Location Impact</b>	
Project directly targets poverty	No	Nation-wide	High
<b>6. Risk Categorization:</b>	Low		
<b>7. Safeguard Categorization</b>	Environment: C Involuntary Resettlement: C Indigenous Peoples: C		
<b>8. Financing</b>			
<b>Modality and Sources</b>		<b>Amount (\$ million)</b>	
<b>ADB</b>		<b>3.00</b>	
Sovereign Program grant: Asian Development Fund		3.00	
<b>Cofinancing</b>		<b>9.10</b>	
New Zealand Grant		0.90	
World Bank		8.20	
<b>Counterpart</b>		<b>0.00</b>	
None		0.00	
<b>Total</b>		<b>12.10</b>	
<b>9. Effective Development Cooperation</b>			
Use of country procurement systems		Yes	
Use of country public financial management systems		Yes	

## I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on a proposed policy-based grant to the Republic of Kiribati for the Strengthening Fiscal Stability Program (SFSP).

2. The program is designed to help the Government of Kiribati increase fiscal sustainability by improving (i) public expenditure quality, (ii) revenue performance, (iii) management of public assets and liabilities, and (iv) the business environment.<sup>1</sup> Policy actions supported under the stand-alone policy-based grant are part of a government-led, multi-year and multi-partner reform effort under the Kiribati Economic Reform Plan (KERP) and are implemented from 1 January to 31 December 2014.<sup>2</sup> A post-program partnership framework supports sustainability of the program.

## II. THE PROGRAM

### A. Rationale

3. Kiribati's fragile, small Pacific island economy faces the challenges of geographic isolation, limited human and financial resources, and a narrow economic base. It is extremely vulnerable to external shocks due to its high exposure to climate change, severe import dependency, and heavy reliance on income from external sources making economic growth highly volatile. The country's private sector is small and restricted by high transport costs and a limited production base. The large public sector crowds out entrepreneurial activity because its state-owned enterprises (SOEs) operate in potentially competitive sectors.<sup>3</sup> Development performance indicators are poor, and vulnerability is widespread.<sup>4</sup>

#### 1. The Kiribati Economy

4. The 2008–2009 global economic crisis contributed to successive contractions of Kiribati's economy in 2009 and 2010. Largely driven by donor-financed infrastructure projects, growth stabilized at close to 3% per annum during 2011–2013.<sup>5</sup> Expanded opportunities for private sector participation in the retail trade sector (through SOE reforms) provided a further boost to economic activity. Without autonomous monetary policy due to the use of the Australian dollar, the government has depended on fiscal policy to manage the impact of shocks and stimulate inclusive growth. To finance fiscal deficits of 7%–21% of gross domestic product (GDP) during 2009–2012, the government relied heavily on drawdowns from the Revenue Equalization Reserve Fund (RERF). The RERF had an estimated value of A\$668 million at the end of 2013, equivalent to 381% of GDP, but drawdowns and losses on RERF investments during the global economic crisis contributed to an almost 50% reduction of the fund's balance in real per capita terms since 2000 limiting the government's ability to manage economic volatility and react to shocks over the long term.

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<sup>1</sup> The design and monitoring framework is in Appendix 1.

<sup>2</sup> The policy matrix is in Appendix 4. Development partners are engaged in ongoing policy reform dialogue related to the KERP and assist its implementation through technical assistance, even when providing budget financing on an intermittent basis.

<sup>3</sup> Government spending is around 100% of gross domestic product, coinciding with high import dependency.

<sup>4</sup> World Bank. 2014. *Hardship and Vulnerability in the Pacific Island Countries*. Washington, DC; Asian Development Bank (ADB). 2004. *Hardship and Poverty in the Pacific*. Manila.

<sup>5</sup> Data in paras. 4–27 is from Asian Development Bank's (ADB) Asian Development Outlook database, if not otherwise indicated.

5. The government's current revenues have risen from an average of 42.5% of GDP in 2009–2011 to an average of about 62.0% in 2012–2013 driven by strong fishing license revenue through the implementation of the vessel day scheme in 2012.<sup>6</sup> However, these increases in fishing license revenue—from 17.4% to 50.5% of GDP in 2011 to 2013—masked an overall decline in tax receipts, which fell from 17.7% to 15.9% of GDP over the same period, due to a narrow tax base, weak tax compliance, and the poor performance by SOEs leading to foregone tax payments. Given its highly volatile revenue base, the government has exercised expenditure restraint. The public sector wage bill remained constant in real terms during 2007–2012, and overall real expenditure declined by 13%. SOE subsidies remain high, however, at 4% of GDP in 2012. The government posted an estimated overall fiscal surplus of 10.3% of GDP in 2013 due to better fishing conditions and the substantial rise in fishing license fees since 2012. Still, it will take time to restore the RERF to sustainable levels.

## 2. Medium-Term Fiscal Framework

6. To develop the economy, increase its resilience to external shocks, and eventually reduce individual hardship and vulnerability in Kiribati, the government aims to steadily improve fiscal sustainability and stabilize the RERF through the adoption of a fiscal framework in 2012 in consultation with the International Monetary Fund (IMF). The framework includes long-term fiscal projections of the current fiscal deficits and real per capita balances in the RERF for a policy stagnation and three reform scenarios.<sup>7</sup> This program supports the implementation of policy actions under the strong reform scenario while the policy stagnation scenario serves as the baseline. In both scenarios, development projects currently under implementation contribute to sustained growth over the near term up to 2016. In the strong reform scenario, fiscal adjustment needs to be gradual to avert strong negative effects on the economy and living standards. A pickup in private sector activity is projected to compensate for the negative effects of this gradual fiscal consolidation during 2015–2018. This leads to the same growth levels as in the baseline scenario over this period (Table). Fiscal reform efforts in the strong reform scenario result in increased tax revenue collection and reduced current expenditures, contributing to improved fiscal sustainability.

7. While avoiding further exposure of the fund to excessive risks is important, RERF long-term performance will depend greatly on the drawdowns to finance current fiscal deficits. Drawdown levels are linked to the undertaking and success or failure of policy reforms to promote growth and limit fiscal pressures. Long-run growth in 2020–2034 under the policy stagnation scenario is projected at 1.9%. Instead, stronger fiscal consolidation is expected to reduce public sector-driven growth significantly. This is projected to be partly offset by greater private sector activity that will support growth of about 1.8% by 2020 under the strong reform scenario.<sup>8</sup> The policy stagnation scenario projects current fiscal deficits of more than 11% of GDP from 2020 onward and an almost complete depletion of RERF resources by 2030. The strong-reform scenario, however, would reduce the current fiscal deficit to about 3.6% of GDP and stabilize the RERF's real per capita value at A\$3,843 (in 2006 prices) by 2024 (Figure).

<sup>6</sup> The scheme was implemented in 2012 by eight Pacific countries that are the parties to the Nauru Agreement. The scheme sets a total number of vessel-days to be allocated between the countries for sale to fishing fleets. The scheme aims at raising fishing license fees while safeguarding the sustainability of the Pacific's tuna stocks.

<sup>7</sup> IMF. 2014. *Kiribati Article IV Consultation 2014*. Washington, DC. This report includes economic and fiscal projections in three scenarios—a reform, strong reform, and strong reform and high fishing license revenue scenario. IMF. 2013. *Kiribati Article IV Consultation 2013*. Washington, DC. This report includes a policy stagnation scenario that has been updated to reflect new fiscal data for 2013. For details on the scenarios, see Revenue Equalization Reserve Fund: Overview (accessible from the list of linked documents in Appendix 2).

<sup>8</sup> While significantly improving the country's fiscal position, measurable fiscal consolidation impacts on growth in the strong reform scenario leading to slightly lower growth by 2020 compared to the baseline scenario.

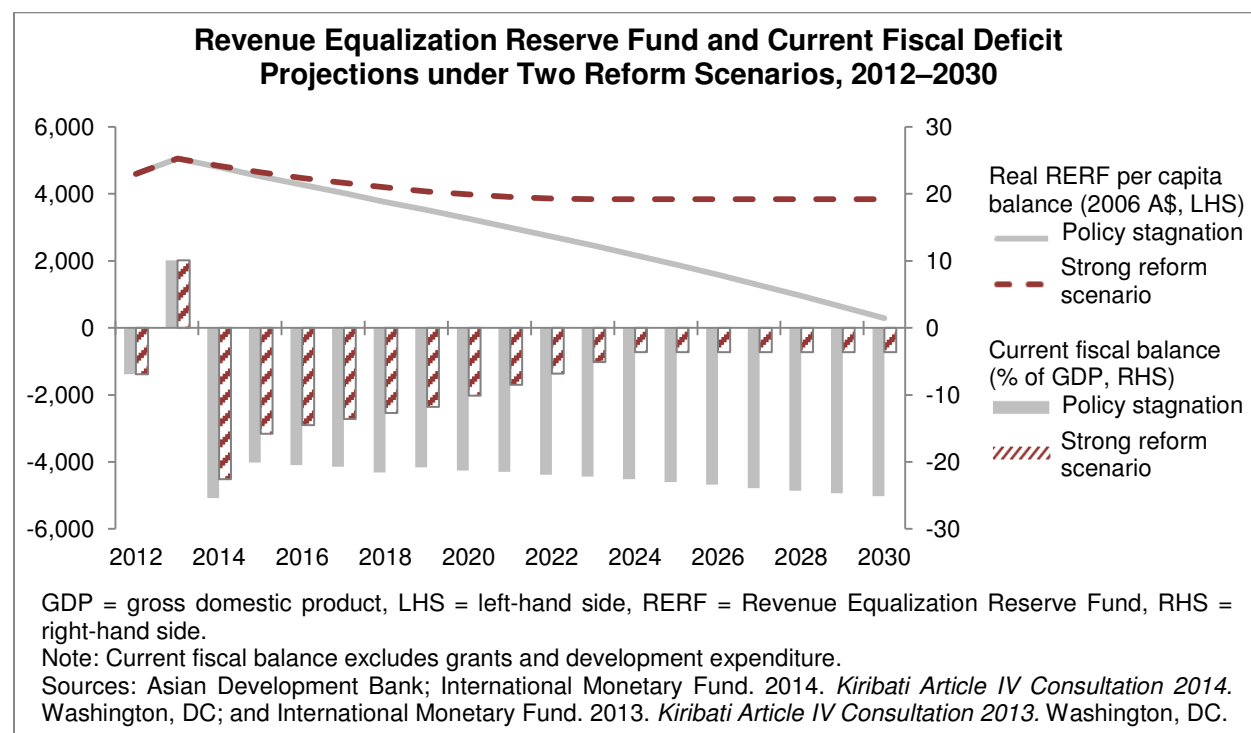
**Economic and Fiscal Projections under Two Reform Scenarios, 2013–2018**  
(% of GDP)

Item	Estimated			Projected		
	2013	2014	2015	2016	2017	2018
<b>Policy Stagnation Scenario</b>						
Real GDP growth	2.9	3.0	2.7	2.5	2.4	2.3
Total revenue and grants	112.9	82.8	82.5	76.6	68.0	59.8
Revenue	69.9	38.0	39.3	38.2	37.7	36.5
Nontax revenue	54.0	25.9	25.3	24.8	24.2	23.7
Fishing license fees	50.5	22.8	22.2	21.7	21.1	20.7
Total expenditure	102.7	111.4	107.2	100.0	91.0	83.3
Current expenditure	59.8	63.4	59.4	58.6	58.3	58.1
Current fiscal balance	10.1	(25.4)	(20.1)	(20.5)	(20.7)	(21.6)
RERF per capita balance (in 2006 A\$)	5,058	4,794	4,521	4,269	4,021	3,760
<b>Strong Reform Scenario</b>						
Real GDP growth	2.9	3.0	2.7	2.5	2.4	2.3
Total revenue and grants	112.9	83.9	84.1	78.9	70.9	64.6
Revenue	69.9	39.1	40.9	40.5	40.2	39.9
Nontax revenue	54.0	25.9	25.3	24.8	24.2	23.7
Fishing license fees	50.5	22.8	22.2	21.7	21.1	20.7
Total expenditure	102.6	109.7	104.5	98.3	89.7	83.1
Current expenditure	59.8	61.7	56.7	54.9	53.7	52.6
Current fiscal balance	10.1	(22.6)	(15.8)	(14.5)	(13.6)	(12.7)
RERF per capita balance (in 2006 A\$)	5,058	4,837	4,643	4,472	4,326	4,192

( ) = negative, GDP = gross domestic product, RERF = Revenue Equalization Reserve Fund.

Note: Current fiscal balance excludes grants and development expenditure.

Sources: Asian Development Bank; International Monetary Fund. 2014. *Kiribati Article IV Consultation 2014*. Washington, DC; and International Monetary Fund. 2013. *Kiribati Article IV Consultation 2013*. Washington, DC.



### 3. Kiribati Economic Reform Plan

8. To restore fiscal sustainability, the government has embarked on a wide-ranging reform program of concrete policy actions as defined in the KERP 2013–2014. The KERP is a medium-term reform program, developed jointly by government–development partner collaborative effort to improve fiscal sustainability.<sup>9</sup> In line with Kiribati Development Plan (KDP), 2012–2015 priorities, the KERP aims to improve (i) expenditure quality, (ii) revenue performance, (iii) the management of public assets and liabilities, and (iv) the business environment supported by the development partners.<sup>10</sup> The Asian Development Bank (ADB), the World Bank, and the Government of New Zealand will be providing (i) budget support in a sequenced manner to support stabilization of the RERF and set incentives to maintain reform momentum, and (ii) technical assistance (TA) to support reform implementation.<sup>11</sup> The KERP incorporates the lessons from ADB’s experience in policy-based operations in the Cook Islands, the Marshall Islands, Nauru, Samoa, Solomon Islands, Tonga, and Tuvalu, as well as the experience of the other development partners across the region, including in Kiribati.<sup>12</sup> Lessons incorporated in the KERP include the need to (i) build strong political consensus for reform, (ii) limit reform to a few substantive areas, (iii) institutionalize a joint government–partner coordination mechanism, and (iv) adopt a medium-term perspective that recognizes the severity of the reform challenges.<sup>13</sup>

9. To demonstrate its commitment to reform, in 2013, the current government (i) approved legislation to improve tax compliance and to introduce a value-added tax (VAT) to broaden the revenue base, (ii) reduced the number of temporary workers in ministries delivering non-essential services, thereby curbing salary expenditures, (iii) approved a debt policy to prevent new nonconcessional borrowing, (iv) established a RERF investment committee, (v) successfully privatized two SOEs and approved a private sector strategy,<sup>14</sup> (vi) upgraded the public financial management (PFM) information system, and (vii) approved a national fisheries policy to strengthen resource management and maximize license revenues. ADB TA has provided crucial support to help the government implement SOE reform.<sup>15</sup>

10. The government is committed to continuing reforms through the rest of its current mandate, which is expected to run until elections due in late 2015. It has requested budget financing from its development partners to help stabilize the RERF and provide incentives for further important reforms. In response, ADB has prepared the SFSP as a stand-alone policy-based operation that will support fiscal management and structural reform—areas of historical

<sup>9</sup> Government of Kiribati. Kiribati Economic Reform Plan, 2013–2014. Unpublished (accessible from the list of linked documents in Appendix 2). PFM and SOE reform plans complement the KERP: Government of Kiribati. PFM Plan, 2011–2014. Unpublished; Government of Kiribati. SOE Stocktake and Recommended Reforms. Unpublished.

<sup>10</sup> Government of Kiribati. 2012. *Kiribati Development Plan, 2012–2015*. Tarawa.

<sup>11</sup> ADB. 2013. *Technical Assistance to the Republic of Kiribati for Enhancing Economic Competitiveness through State-Owned Enterprise Reform*. Manila. This is complemented by other development partners’ support in the remaining reform areas.

<sup>12</sup> ADB. 2009. *Special Evaluation Study: ADB’s Support for Public Sector Reforms in the Pacific*. Manila; Program completion reports of ADB’s policy-based lending operations in 2010–2013 also provide relevant lessons.

<sup>13</sup> The government and development partners support a gradual transition from growth driven by public expenditure to broader-based growth powered by greater private sector activity. However, they also recognize the need to maintain basic social services and the importance of subsidies and wages to support livelihoods and as a form of social protection. Abrupt fiscal adjustment would jeopardize development outcomes and further deepen hardship and vulnerabilities.

<sup>14</sup> Implementation is supported by development partners through investments in transport infrastructure, financial, and energy sector development; telecommunication sector liberalization; and skills development.

<sup>15</sup> ADB. 2008. *Technical Assistance to the Republic of Kiribati for Economic Management and Public Sector Reform*. Manila.



ADB involvement in Kiribati. The SFSP is consistent with the KDP; ADB's Pacific Approach, 2010–2014; and ADB's country partnership strategy for Kiribati for 2010–2014.<sup>16</sup>

## B. Impact and Outcome

11. The impact will be improved fiscal sustainability in Kiribati, as prioritized in the KDP and in line with the government's fiscal framework and the KERP. The impact will be measured against targets for improvement in the RERF's real per capita value and the government's current fiscal deficit. The outcome of the program will be government capacity for fiscal stabilization built. Outcome progress will be tracked against targets for increased VAT revenue collection and reduced subsidies to SOEs.

## C. Outputs

12. The outputs align with four priority policy reform goals that put the country on a path toward fiscal stability. The SFSP aims to improve (i) the quality of public expenditure, (ii) revenue performance, (iii) the management of public assets and liabilities, and (iv) the business environment. All 12 policy actions under the program have been completed.

13. **Output 1: Improved quality of expenditure.** Kiribati's economy is heavily dependent on public expenditure. There is limited scope at this point to reduce spending on wages or core social services without negatively affecting social outcomes and livelihoods, but expenditure quality can be improved by rationalizing SOE subsidies. A government review of its copra subsidy scheme concluded that Kiribati's coconut industry is not financially viable. The involvement of six agencies in administration of the subsidy has also led to poor coordination, unnecessary double handling of products, and limited accountability leading to a "leakage" of about 40% of the subsidy in 2010 (\$2.1 million) and 2011 (\$3.6 million).<sup>17</sup> The government aims to replace copra subsidies in the long term with a better-targeted form of social assistance, but this will take time, given the reliance on the copra subsidy in Kiribati society. The cabinet approved the review recommendation to merge the Kiribati Copra Mill and the Kiribati Copra Cooperative Society into a single SOE responsible for the entire sector. This will increase accountability, makes cost structures more transparent, and improves efficiency and reduces leakages. The merger will ensure that copra subsidies achieve their main purpose of supporting livelihoods in the outer islands until a better transfer scheme is designed.

14. The government has also prioritized implementation of core provisions of the 2013 SOE Act to minimize the fiscal drain to inefficient SOEs through the replacement of subsidies with community service obligations (CSOs).<sup>18</sup> All subsidies to SOEs were cut in the 2015 budget process. The new process requires SOEs to submit CSO bids to the Ministry of Finance and Economic Development (MFED) during the budget process. This has formed the basis for a transparent CSO negotiation process between MFED and SOEs in which costs can be clearly assigned to specific services. These negotiations reduce wastage and provide the government with better value for money and allow for more strategic resource allocation.

15. **Output 2: Improved revenue administration.** With assistance from the Government of Australia and the Pacific Financial Technical Assistance Center, the government implemented

<sup>16</sup> ADB. 2009. *Pacific Approach, 2010–2014*. Manila; ADB. 2010. *Country Partnership Strategy: Kiribati, 2010–2014*. Manila.

<sup>17</sup> Government of Kiribati. Proposed Institutional Reform of Kiribati Coconut Sector. Unpublished.

<sup>18</sup> The act requires SOEs to operate as commercial entities. In cases where SOEs are performing unprofitable services for the benefit of the public, they can request the government for support through CSO funding.

the VAT on 1 April 2014 (para. 9). This was in response to declining revenues from personal income and company taxes and a phasing out of trade taxes. Sound implementation is expected to at least offset the loss of revenue from the phased-out import duties within the first year of full implementation in 2015, broaden the tax base in the long run, and increase overall tax revenue yield. The SFSP supported these efforts by reviewing VAT implementation over the first quarter. It identified bottlenecks and capacity gaps that are being addressed by government in collaboration with the development partners supporting revenue administration in Kiribati.

16. Receipts from tuna fishing license fees represent 40%–70% of current government revenue in 2009–2013. There is a need to ensure that such information on the fishing license revenue is shared properly by agencies within the government. A lack of transparency in fisheries license agreements creates uncertainty in the projection of revenues. It also likely reduces the amounts remitted to the government general account. The program established a joint committee between the Ministry of Fisheries and Marine Resource Development and the MFED to facilitate collaboration and information sharing on fishing license revenue between the two ministries. The committee produced a report detailing collections for 2013 under the program, which provides the basis for a planned analysis and review of fishing license agreements aimed at achieving government policy objectives. This intragovernment information sharing is a first step toward optimizing the fisheries sector and (i) enables the government's budget team to make meaningful projections, thereby improving budget credibility; and (ii) allows the MFED to make a reliable assessment and advise the cabinet on whether Kiribati is (a) maximizing the sustainability and value of its fisheries resources through existing and future license agreements and joint venture arrangements, and (b) complying with catch limits and other conditions established under regional frameworks.

17. **Output 3: Improved management of public assets and liabilities.** Sound management of the RERF assets is another key to restoring fiscal sustainability. Losses incurred on investments during the global economic crisis highlighted inadequacies in the management arrangements. A review of the RERF management recommended (i) improving alignment between strategic asset allocation and investment objectives, (ii) revising investment guidelines to remove ambiguity and avoid excessive risk taking, and (iii) adopting more appropriate mechanisms for monitoring and assessing the performance of asset managers. The SFSP required the cabinet to approve and implement these reforms to achieve greater alignment between RERF management and strategy objectives. This included the reallocation of the RERF's assets to new asset managers, who will operate under set guidelines, and the reorientation of the portfolio towards lower-risk instruments. Asset allocation is to be 25% in public equities and 75% in bonds.

18. The government's fiscal position also suffers from weak debt management. The results have included (i) accumulation of substantial debt at high interest rates, including the use of a high-interest overdraft facility, despite the government's ability to access financing at a lower cost from the RERF, (ii) a lack of information on how much debt is outstanding, and (iii) the contracting of government debt and guarantees without the knowledge of all cabinet members or appropriate advice from the MFED. The SFSP supported implementation of a new debt policy adopted by the government in 2013 and required the MFED to appoint an officer dedicated to debt policy monitoring. This is intended to (i) ensure that loan and guarantee decisions are based on appropriate advice and guided by strategic policy considerations; (ii) avoid recourse to expensive commercial borrowing; and (iii) prevent reaccumulation of overdraft balances and the inappropriate granting of further loan guarantees to SOEs and joint ventures.

19. **Output 4: Improved structural reform implementation.** Inefficient SOEs dominate large parts of the economy crowding entrepreneurial activity out of potentially competitive sectors and drain government fiscal resources. ADB TA projects have supported the significant SOE reform efforts undertaken by the government since 2012 (footnotes 11). These led to the passing of the SOE Act in 2013, initiation of restructuring and privatization processes for selected SOEs, and an improved oversight framework that brought about better corporate governance. The government's SOE reform road map has identified specific SOEs for restructuring to improve SOE efficiency and promote private sector participation in the economy. The SFSP supported the restructuring of four SOEs—the Kiribati Shipping Services; the Plant and Vehicle Unit (PVU), which purchases and maintains government vehicles; Bobotin Kiribati, a food wholesaler; and Betio Shipyard. To improve SOE efficiency and reduce the fiscal drain, the SFSP required SOEs to develop statements of intent that include projections for cash flows, annual balance sheets, and annual profits; submit financial statements for audit; and ensure that all board appointments are in full compliance with the act. An exception to the latter requirement involves the advisory committee of the PVU. This is due to legal ambiguity over whether the PVU falls under the SOE Act or is a special fund as defined in the PVU Act.

#### **D. Development Financing Needs**

20. The government has requested a grant not exceeding \$3.0 million from ADB's Special Funds resources (i) to help meet the financing gap for the 2014 fiscal year; and (ii) to incentivize the political approval and technical implementation of the KERP policy reform actions needed to gradually move toward fiscal sustainability in the long term. The government forecasts its financing requirements for 2014 to be \$37.1 million (22.6% of GDP), \$26.9 million in 2015 (15.8% of GDP), and \$25.6 million in 2016 (14.5% of GDP). These estimates project a subsequent decline of these needs to a sustainable level of 3.6% of GDP by 2025. The ADB, the Government of New Zealand, and the World Bank jointly support the implementation of the KERP, with the two partners providing collaborative cofinancing of Kiribati's budget in 2014 in the amount of \$0.9 million (New Zealand) and \$8.2 million (World Bank). This joint assistance allows the government to reduce RERF drawdowns by \$12.1 million in 2014 and contributes to the fund's long-term stabilization. Continuous financial support by development partners is expected over the medium term within the programmatic framework of the KERP.

21. The successful implementation of the SFSP will (i) immediately save the government over \$2.0 million in subsidies in 2015 by reducing leakages (para. 13); (ii) allow better use of government funds and a reduction of wastage through use of CSOs (para. 14), (iii) reduce public debt to \$1.0 million by 2015 and save future servicing costs through better debt management, and (iv) reduce fiscal risks from SOEs and thereby limit potential negative implications on the budget. On the revenue side, the government is expected to generate revenue of \$12.4 million in 2014 (7.6% of GDP) from VAT increasing to 10.2% of GDP by 2019 (para. 15). The government is also making progress in substantially increasing fisheries license fee revenues (para. 16). ADB determined the proposed program grant amount based on the available Asian Development Fund allocation for Kiribati, the government's progress in implementing its ambitious reform agenda, and the need to maximize leverage for political approval and technical implementation of the KERP policy reform actions.

#### **E. Implementation Arrangements**

22. **Program management.** The MFED, as the executing agency, oversees timely implementation of the agreed policy actions by the implementing agencies and is responsible for program administration, disbursements, and maintaining all records. The MFED acts as the joint

implementing agency with the Ministry of Commerce, Industries, and Cooperatives for output 1; with the Ministry of Fisheries and Marine Resource Development on reporting fisheries revenues for output 2; and with the Ministry of Communication, Transportation, and Tourism Development and the Ministry of Public Works and Utilities for outputs 3 and 4. To help deliver these last two outputs, it works through an established SOE reform steering committee that comprises the secretaries from these ministries, an official from the Lands Department, and the secretary to the cabinet. ADB and other development partners have provided and will continue to make available TA support to help the government accomplish the policy actions and achieve program outcomes (footnote 11). Program and post-program partnership framework monitoring will be carried out by the MFED, complemented by oversight by the economic working group of the government and development partners that monitors KERP implementation.<sup>19</sup>

**23. Implementation period.** The program is being implemented from 1 January to 31 December 2014, consistent with the government's medium-term fiscal framework and budget cycle.

**24. Procurement and disbursement.** The grant proceeds will be disbursed in accordance with ADB's simplification of disbursement procedures and related requirements for policy-based grants.<sup>20</sup> The proceeds will be used to finance the foreign exchange cost of items produced and procured in ADB member countries, excluding items included in a list of ineligible items and imports financed by other bilateral and multilateral sources.<sup>21</sup> Grant proceeds disbursed against imports will require a certificate from the government stipulating that the value of the total imports of Kiribati, minus its imports from nonmember countries, ineligible imports, and imports financed under other official development assistance, is greater than the amount of the grant expected to be disbursed in 2014. ADB will have the right to audit the use of the grant proceeds and to verify the accuracy of the government's certification.

**25. Tranches and counterpart funds.** The grant will be provided in a single tranche and may be withdrawn upon satisfaction of grant effectiveness conditions—i.e., fulfillment of all program policy actions (Appendix 4). Local currency generated from the grant will be directed to the government's bank account with the Australia and New Zealand Banking Group to allow financial assistance for the 2014 budget.

**26. Program performance monitoring and evaluation.** The government monitors the implementation and outcome of the SFSP, using a set of indicators and targets that has been agreed between the government and ADB. For each of the agreed indicators, progress is measured against the baselines in the design and monitoring framework (Appendix 1). The responsible implementing agencies support the review of agreed actions to determine progress and identify constraints. Because the outcome of the program will be felt beyond the period of its implementation, the MFED will continue monitoring program performance until the end of 2015, and KERP monitoring will be carried out on a continuous basis by the economic working group of the government and development partners. The information from this monitoring will be included in the program completion report.

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<sup>19</sup> The economic working group is composed of representatives from the government and development partners, including ADB, and is chaired by the secretary for finance and economic development.

<sup>20</sup> ADB. 1998. *Simplification of Disbursement Procedures and Related Requirements for Program Loans*. Manila.

<sup>21</sup> List of Ineligible Items (accessible from the list of linked documents in Appendix 2).

### III. DUE DILIGENCE

#### A. Economic and Financial

27. Strengthened fiscal management and budget restraint by the government will slow the deterioration of the RERF's real per capita value.<sup>22</sup> The IMF projects that this value will stand at A\$4,192 (in 2006 Australian dollars) in 2018 with the implementation of reforms supported by the SFSP, compared with A\$3,760 if policy stagnates and no reforms are undertaken. The current fiscal deficit is also projected to reduce to 12.7% of GDP in 2018, compared with 21.6% if policy does not change. These improvements will result in a more sustainable fiscal position over the long term and build the government's ability to respond to external shocks. Individual reform actions will improve the quality of expenditures, strengthen the government's revenue position, and improve the management of assets and liabilities, while opening up selected sectors to private competition with the aim of increasing employment and reducing consumer prices.

#### B. Governance

28. A 2010 public expenditure and financial accountability assessment identified weaknesses in the government's PFM systems.<sup>23</sup> Since then, development partners have helped the government design and implement a PFM plan for 2011–2014 by (i) putting in place a medium-term budget framework to underpin strategic allocation of resources, (ii) strengthening the customs and tax departments for VAT implementation, (iii) developing capacity of the National Economic and Planning Office to improve planning and budgeting linkages, (iv) strengthening the government's Accounting Department in the use of accounting software and preparation of financial reports, and (iv) developing external audit capacities.<sup>24</sup>

29. A review of the public procurement system was undertaken in 2012–2013. As indicated in the post-program partnership framework, the government is planning to implement proposed changes by mid-2015. PFM reform actions have also been supported by the KERP. The PFM system upgrade that introduced a commitment control system allows the MFED to control budget execution across the government. A PFM advisor, financed by the European Union, will be engaged to support downstream PFM functions and capacity development in early 2015. These achievements and the post-program partnership framework demonstrate the government's strong commitment to credible and effective budget management. ADB's Anticorruption Policy (1998, as amended to date) was explained to and discussed with the government.

#### C. Poverty and Social

30. Fiscal stabilization will have positive impacts on the delivery of social services in Kiribati. Redundancies will be avoided during SOE rationalization, and some SOE workers will transition into the private sector as this takes on the SOE functions. Others will be retained in the public sector.<sup>25</sup>

<sup>22</sup> Sector Assessment (Summary): Public Sector Management and Revenue Equalization Reserve Fund: Overview (accessible from the list of linked documents in Appendix 2)

<sup>23</sup> Government of Kiribati. 2010. *Kiribati Public Financial Management–Performance Report*. Tarawa.

<sup>24</sup> ADB. 2011. *Technical Assistance to the Republic of Kiribati for Strengthened Public Financial Management*. Manila; ADB. 2013. *Technical Assistance for Implementing the Pacific Regional Audit Initiative (Phase 2)*. Manila.

<sup>25</sup> Summary Poverty Reduction and Social Strategy (accessible from the list of linked documents in Appendix 2).

#### **D. Safeguards**

31. Program activities are confined to policy and institutional reforms, and none of the activities will result in or lead to involuntary resettlement or affect indigenous peoples. Safeguard categories for environment, involuntary resettlement, and indigenous peoples are all C. No adverse environmental impacts have been identified. Public consultations were carried out during the processing of the program.

#### **E. Risks and Mitigating Measures**

32. The program's overall risk is rated medium, with three key risk factors identified.<sup>26</sup> With elections due in 2015, the political consensus needed to achieve the intended fiscal and SOE management reforms may prove more difficult to obtain than is anticipated. Staff turnover in MFED could leave too few qualified and experienced personnel to manage implementation of program elements. Kiribati's extreme vulnerability to shocks could diverge fiscal indicators from those envisaged and targeted. The program has been designed to mitigate these risks. The post-program partnership framework constitutes a mitigation strategy against potential weakening of the government reform commitment. Political consensus is being obtained and sustained through government ownership and leadership of the KERP process and by continuous outreach to parliamentarians and the general public building on an already high level of media coverage and public awareness to build wide stakeholder support for reform and the role of development partners in supporting the government's efforts through budget financing and TA. To help offset the risk of skills shortages, government staff resources are supplemented through ADB and other development partners' TA projects. Fiduciary risks have been addressed through the PFM reform plan activities (paras. 28–29).

### **IV. ASSURANCES**

33. The government has assured ADB that implementation of the program shall conform to all applicable ADB policies, including those concerning anticorruption measures, safeguards, gender, procurement, consulting services, and disbursement as described in detail in the grant agreement. The government has agreed with ADB on certain covenants for the program, which are set forth in the grant agreement. The grant will become effective after ADB is satisfied that all conditions for the release of the program tranche, as specified in the policy matrix and set out in Attachment 2 to Schedule 2 of the draft grant agreement, have been complied with.

### **V. RECOMMENDATION**

34. I am satisfied that the proposed policy-based grant would comply with the Articles of Agreement of the Asian Development Bank (ADB) and, acting in the absence of the President, under the provisions of Article 35.1 of the Articles of Agreement of ADB, I recommend that the Board approve the grant not exceeding \$3,000,000 to the Republic of Kiribati from ADB's Special Funds resources for the Strengthening Fiscal Stability Program, on terms and conditions that are substantially in accordance with those set forth in the draft grant agreement presented to the Board.

Bindu N. Lohani  
Ranking Vice-President

5 November 2014

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<sup>26</sup> Risk Assessment and Risk Management Plan (accessible from the list of linked documents in Appendix 2).

## DESIGN AND MONITORING FRAMEWORK

Design Summary	Performance Targets and Indicators with Baselines	Data Sources and Reporting Mechanisms	Assumptions and Risks
<p><b>Impact</b> Improved fiscal sustainability</p>	<p>By 2018: RERF real per capita value is no less than A\$4,192<sup>a</sup> (Baseline: 2018 value of A\$3,760<sup>a</sup> is projected in policy stagnation scenario in simulations by IMF and ADB)</p> <p>Current fiscal deficit reduced to 12.7% of GDP (Baseline: 2018 deficit of 21.6% of GDP is projected in policy stagnation scenario in simulations by IMF and ADB)</p>	<p>National budget documents</p> <p>RERF annual reports</p> <p>National budget documents</p> <p>IMF Article IV reports</p>	<p><b>Assumptions</b> Government maintains fiscal discipline and implements ambitious reforms.</p> <p>No major adverse economic shocks occur.</p> <p><b>Risk</b> Broad reform consensus weakens due to political pressure.</p>
<p><b>Outcome</b> Government capacity for fiscal stabilization built</p>	<p>By December 2015: VAT revenue grows to 9.9% of GDP (2013 baseline: 0.0% of GDP)</p> <p>Subsidies to SOEs, excluding explicit CSOs, eliminated (2012 baseline: 4.0% of GDP)</p>	<p>National budget documents</p> <p>SOE monitoring unit report</p> <p>National budget documents</p>	<p><b>Assumption</b> Kiribati Economic Reform Plan implementation continues.</p> <p><b>Risk</b> Capacity constraints and staff turnover reduce continuity and quality of reform implementation.</p>
<p><b>Outputs</b></p> <p>1. Quality of expenditure improved</p> <p>2. Revenue administration improved</p>	<p>By December 2014:</p> <p>Merger of KCCS and KCML approved by cabinet (2013 baseline: KCCS and KCML are separate entities)</p> <p>SOE subsidies, in the form of CSOs, are fully reflected in the annual budget (2013 baseline: No CSOs in 2013 budget)</p> <p>VAT system put in place and administered (2013 baseline: No VAT system)</p> <p>A joint MFMRD and MFED report on fisheries license</p>	<p>Ministry of Commerce, Industries and Cooperatives annual report</p> <p>National budget documents</p> <p>MFED annual reports</p> <p>MFMRD and MFED joint report</p>	<p><b>Assumptions</b> Government maintains commitment to reform public finances.</p> <p>Government maintains commitment to improve SOE governance and to rationalize selected SOEs.</p> <p><b>Risks</b> Stakeholders interfere with reform process due to opposing individual interests.</p> <p>Staff changes and already high workload reduce continuity and quality of reform implementation.</p>

Design Summary	Performance Targets and Indicators with Baselines	Data Sources and Reporting Mechanisms	Assumptions and Risks
3. Management of public assets and liabilities improved	<p>revenue performance in 2013 is completed (2013 baseline: No report on fisheries revenues)</p> <p>No new nonconcessional loans taken on by government and SOEs, as agreed to in the debt management strategy (2013 baseline: A\$8.8 million in new nonconcessional loans)</p> <p>Cabinet approves RERF management policies (2013 baseline: No RERF management policies exist)</p>	<p>MFED annual reports</p> <p>Cabinet minutes</p>	<p>Limited capacity in the MFED to reform SOEs and scrutinize financial performance leading to lack of implementation of reform strategies.</p>
4. Structural reform implemented	<p>Rationalization strategies for BSL, BKL, KSSL, and PVU approved by cabinet (2013 baseline: No existing rationalization strategies)</p> <p>Board appointments in all SOEs comply fully with legislative provisions of SOE act 2013 (except appointments of the advisory committee of PVU) (2013 baseline: No SOEs complied with SOE act for board appointments)</p> <p>Fully costed SOIs for 15 SOEs submitted for information to cabinet and parliament (2013 baseline: No SOEs had fully costed SOIs)</p>	<p>Cabinet minutes</p> <p>SOE monitoring unit annual reports</p> <p>Attorney General's Office reports</p> <p>Cabinet minutes</p>	



Activities with Milestones	Inputs
<p><b>1. Improved quality of expenditure (30 September 2014)</b></p> <p>1.1 MFED develop strategy for the merger of KCCS and KCML and seek cabinet approval for implementation</p> <p>1.2 SOEs managements develop CSO bids and submit these to MFED for negotiation in preparation of the 2015 budget</p> <p><b>2. Improved revenue administration (31 August 2014)</b></p> <p>2.1 Government establishes VAT system, and Tax Department trains staff on its administration</p> <p>2.2 The joint MFMRD and MFED fisheries management committee prepares a report on fisheries license revenue performance in 2013</p> <p><b>3. Improved management of public assets and liabilities (31 July 2014)</b></p> <p>3.1 MFED appoints a debt management officer to monitor the implementation of the national debt management policy</p> <p>3.2 MFED finalizes RERF management policies, and they are submitted for cabinet approval</p> <p><b>4. Improved structural reform implementation (31 August 2014)</b></p> <p>4.1 MFED prepares invitation for expression of interest for privatization of BSL and seeks cabinet approval</p> <p>4.2 MFED develop rationalization strategies for PVU, BKL, and KSSL; and seek cabinet approval for implementation</p> <p>4.3 Shareholding ministers appoint all SOE boards in full compliance with the SOE act (except appointments of the advisory committee of PVU)</p> <p>4.4 SOE managements develop fully costed SOIs for 15 SOEs</p>	<p><b>ADB:</b> \$3.0 million</p> <p><b>World Bank:</b> \$8.2 million (collaborative cofinancing)</p> <p><b>New Zealand:</b> \$0.9 million (collaborative cofinancing)</p> <p><b>Government:</b> Fulfillment of grant conditions and counterpart support for technical assistance</p>

ADB = Asian Development Bank, BKL = Bobotin Kiribati Limited, BSL = Betio Shipyard Limited, CSO = community service obligation, GDP = gross domestic product, IMF = International Monetary Fund, KCCS = Kiribati Copra Cooperative Society, KCML = Kiribati Copra Mill Limited, KSSL = Kiribati Shipping Services Limited, MFED = Ministry of Finance and Economic Development, MFMRD = Ministry of Fisheries and Marine Resource Development, PVU = Plant and Vehicle Unit, RERF = Revenue Equalization Reserve Fund, SOE = state-owned enterprise, SOI = statement of intent, VAT = value-added tax.

<sup>a</sup> In 2006 Australian dollars.

Source: Asian Development Bank.

### **LIST OF LINKED DOCUMENTS**

<http://www.adb.org/Documents/RRPs/?id=47314-001-2>

1. Grant Agreement
2. Sector Assessment (Summary): Public Sector Management
3. Contribution to the ADB Results Framework
4. Development Coordination
5. Country Economic Indicators
6. International Monetary Fund Assessment Letter
7. Summary Poverty Reduction and Social Strategy
8. Risk Assessment and Risk Management Plan
9. List of Ineligible Items

### **Supplementary Documents**

10. Kiribati Economic Reform Plan, 2013–2014
11. Macroeconomic Performance: Overview
12. Revenue Equalization Reserve Fund: Overview



GOVERNMENT OF KIRIBATI  
 MINISTRY OF FINANCE AND ECONOMIC DEVELOPMENT  
 P.O. Box 67, BAIRIKI, TARAWA. Telephone: 686 21806 Ext 212.

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**DEVELOPMENT POLICY LETTER**

Mr. T. Nakao  
 President  
 Asian Development Bank  
 6 ADB Avenue  
 Mandaluyong, Metro Manila  
 Philippines

30 September 2014

**Letter of Development Policy from the Republic of Kiribati  
 Strengthening Fiscal Stability Program**

Dear Mr. Nakao,

As one of the most remote and dispersed small island economies, Kiribati faces severe fiscal and economic challenges. In the past years, adverse external economic conditions have impacted Kiribati through several channels. Declines in remittances have contributed to weak growth and price shocks have led to periods of high inflation, while disruption in global financial markets saw the value of our sovereign wealth fund, the Revenue Equalization Reserve Fund (RERF), decline significantly in the aftermath of the global financial and economic crisis. Climate change impacts—including coastal area inundation, saltwater intrusion, and erratic rainfall—continue to pose an existential threat to our country.

Between 2004 and 2013, economic growth was volatile, ranging from -4.5% to +7.5% per annum driven largely by the public sector. The government, in consultation with the International Monetary Fund (IMF), estimates economic growth rose slightly to 2.9% in 2013 driven by the private retail sector and donor-funded projects. Donor-funded projects are projected to raise growth to 3.0% in 2014 before rates are expected to return to a medium-term path of 2.7% in 2015. The completion of major donor-funded projects over the next years is projected to gradually slow down growth in the long-term to about 1.9% per annum.

The trade deficit is forecast to reach 58.2% and 58.8% of GDP in 2013 and 2014 as a result of increased demand for imports associated with donor infrastructure projects. The current account deficit is projected to increase from 27.4% of GDP in 2013 to 53.4% in 2014. Consumer price inflation is forecasted to increase from -1.5% to 2.5% in 2014.

Tax revenues have declined over recent years due to weak growth, problems with tax administration, and tax non-compliance of state-owned enterprises (SOEs). Expenditure has outpaced revenue—driven by an extensive public sector, including inefficient SOEs—leading to widening budget deficits. However, the government has taken decisive action to control expenditure while at the same time safeguarding allocations for basic social services. With higher-than-expected revenues from fishing licenses in 2012 and 2013 improved the fiscal position, reducing the current deficit to 8.8% of gross domestic product (GDP) in 2012 (from over 20% of GDP in the previous year) and resulting in a surplus of 11.3% of GDP in 2013. Still, the government's fiscal position is under significant pressure and we are projecting a current deficit equivalent to 22.6% of GDP for 2014 due to an expected normalization in fishing license revenues to pre-2012 levels.

So far, the deficits have been largely financed through drawdowns from the RERF, which is was until 2012 being depleted at an unsustainable rate. The International Monetary Fund (IMF) projects a continuous decline in the real value of the RERF if drawdowns are maintained at pre 2013 levels. Recognizing the importance of the RERF as the country's main fiscal buffer, we are strongly committed to the stabilization and replenishing of the RERF, and have recently deposited \$10 million, equivalent to 47% of our 2013 fiscal surplus, into it.

In response to the tight fiscal situation, and in recognition of the importance of maintaining fiscal sustainability in the medium term, the government has, in consultation with the IMF, developed a medium-term fiscal framework to underpin the significant fiscal adjustment that is required. The IMF, in its 2014 Article IV consultation report, further highlighted the need for our government not only to reduce the large and structural fiscal imbalances, but also to increase growth and employment opportunities. The fiscal framework is therefore complemented by the Kiribati Economic Reform Plan (KERP), which covers both fiscal and structural reforms. The KERP was prepared in collaboration with the Asian Development Bank (ADB), the Governments of Australia and New Zealand, and the World Bank. It facilitates coordinated policy dialogue and technical assistance, and has helped the government to prioritize reform activities. Development partners use the KERP to provide a series of budget support operations to Kiribati, which provide us with fiscal space for reform implementation. While the KERP is currently covering reform activities over the duration of one year—given government's limited capacities for consulting upon and coordinating the design and implementation of a longer-term plan—the government aims to gradually expand it into a medium-term reform plan, in line with our overarching long-term objectives of fiscal stability and inclusive growth.

In line with the Kiribati Development Plan 2012–2015 priorities, the reform agenda is aimed at improving (i) public expenditure quality; (ii) revenue performance; (iii) management of public assets and liabilities; and (iv) the business environment. To raise the quality of public expenditure, the government reduced the number of temporary workers in non-priority ministries and approved the SOE Act, which provides the legal framework for an SOE reform program supporting good practices in governance, financial reporting, oversight, and management of SOEs with the target of reducing fiscal drain from inefficient SOEs. To increase revenue, the government (i) implemented a value-added tax (VAT) to broaden the revenue base and (ii) approved the National Fisheries Policy, which will provide a sound policy basis for improving the management of this vital resource to both increase revenues and safeguard sustainability. To improve the management of public assets and liabilities the government (i) has cleared government's overdraft debt (ii) approved a debt policy, which will ensure that appropriate processes are applied in the contracting of any new public sector borrowing, and (iv) is

reviewing current arrangements for the management of RERF assets to implement important reforms to ensure a more appropriate risk exposure and that investment strategies are aligned with fund objectives. To enhance the business environment and expand private sector opportunities, the government has recently developed a private sector development strategy. Further, the parliament passed a law to liberalize the telecommunications sector, and facilitate private participation. This is expected to benefit the people of Kiribati through increased coverage, improved services, and reduced prices.

The Government of Kiribati commits to fulfilling the following specific actions prior to grant effectiveness, which is scheduled no later than 31 November 2014:

- Cabinet approval of the merger of the Kiribati Copra Cooperative Society (KCCS) and Kiribati Copra Mill Limited;
- A review of the first three months of VAT system implementation, which will comprise data on revenue collected, and issues and challenges of implementing VAT.
- The Ministry of Finance and Economic Development (MFED) and the Ministry of Fisheries and Marine Resources Development jointly produce a report on fisheries license revenue performance for 2013 containing disaggregated data regarding the sources of fishing revenues.
- Cabinet approval of key RERF management reforms to achieve consistency with clearly-stated investment objectives, including: i) reallocation of RERF assets to new asset managers with set criteria; and ii) reorientation of the portfolio towards lower-risk instruments, with 25% public equities and 75% bonds.
- MFED appointment of a staff whose principal role is to enforce the implementation of the Debt Policy as approved by Cabinet in 2013.
- Cabinet approval of (i) a comprehensive study to contracting out of shipping service management including the management of the government vessel, (ii) appointment of a liquidator for and Bobotin Kiribati Limited; and (ii) changes to the Government Plant and Vehicle Fund's (PVU's) activities.
- Cabinet approval of an invitation for expressions of interest for private firms to enter into a public-private partnership concession agreement for Betio Shipyard Limited.
- SOEs submit bids for community service obligations for negotiation with MFED in preparation for the 2015 budget, with other subsidies to SOEs reduced to zero in the national budget.
- Receipt of 2014 statements of intent for all SOEs by the Government's SOE Monitoring Unit. The statements should specify each SOE's (i) main objectives; (ii) projected annual cash flow; (iii) projected annual balance sheet; and (iv) projected annual profits.
- The five largest SOEs—Kiribati Oil Limited, Kiribati Housing Authority, Public Utility Board, Broadcasting and Publications Authority, and Air Kiribati Limited—submit their 2013 financial accounts to the Office of the Auditor General for auditing.
- All appointments to SOE boards (except PVU) will comply with the SOE Act 2013.

While our reform plan only covers activities for the current year, I want to assure you that we are dedicated to keeping up the reform momentum and continue reform implementation into the medium term. We have therefore committed ourselves to a post-program partnership with the ADB, which will maintain focus on the four broad areas of the KERP—improving public expenditure quality, revenue performance, management of public assets and liabilities, and the business environment. The Economic Working Group, chaired by MFED and with participation of major development partners including ADB, will continue overseeing reform design and


implementation, allowing for continuous policy dialogue with a medium-term perspective. KERP policy reform areas for 2015–2016 that we want to raise during consultations with our development partners for actions are:

- Continue to improve the quality of public expenditure, including through:
  - Review of the government procurement policy and procedures with a focus on improving transparency, accountability, and value for money; and
  - Increasing allocations for basic social services;
- Explore opportunities to improve revenue performance further;
- Complete implementation of agreed upon reform measures for RERF management and further replenishing of the RERF by injecting windfall revenues from fishing license fees;
- Continue with the implementation of the SOE reform roadmap; and
- Implementation of the private sector development strategy, which was approved this year

I therefore seek ADB’s favourable consideration of a program grant of \$3.0 million, which is to be disbursed in a single tranche in 2014. The program’s policy matrix, including its post-program partnership framework, is in line with the policy reform milestones contained in the KERP.

I am confident that the Government of Kiribati’s strong ownership, supported by financial and technical assistance from ADB and other partners, and effective development partner collaboration over the medium term will result in the successful achievement of the government’s reform objectives to the benefit of the people of Kiribati.

Yours sincerely



Hon. Tom Murdoch  
Minister of Finance and Economic Development  
Government of Kiribati

## POLICY MATRIX

Output	Conditions to Grant Proceeds Release	Post-Program Partnership Framework
<b>Output 1: Improved quality of expenditure</b>	<b>Policy Action 1.1:</b> Cabinet shall have approved the merger of the Kiribati Copra Cooperative Society and Kiribati Copra Mill Limited.  <i>(Excerpt from Cabinet minutes certified by the Cabinet Secretary)</i>	Government to sustain efforts to improve the quality of expenditure by: (i) continuing to reflect SOE CSOs in future national budgets, and eliminating any other subsidies to SOEs; and (ii) government procurement reform to enhance transparency, accountability, and value for money. These measures should allow for increasing budgetary allocations to the Ministry of Education and Ministry of Health and Medical Services, to safeguard basic social service expenditure.
	<b>Policy Action 1.2:</b> SOEs shall have submitted bids for community service obligations for negotiation with MFED in preparation for the 2015 budget with other subsidies to SOEs reduced to zero in the national budget.  <i>(Letter from the Secretary of MFED certifying that SOE bids have been received)</i>	
<b>Output 2: Improved revenue administration</b>	<b>Policy Action 2.1:</b> MFED shall have conducted a review of the first quarter following the implementation of the VAT system, which shall comprise data on revenue collected, issues and challenges of implementing VAT.  <i>(Copy of the VAT Act, certified by the Cabinet Secretary, and report from the MFED, certified by the Secretary of the MFED, reviewing the first quarter of the VAT system's implementation).</i>	MFED to explore further opportunities to raise revenue collections.  To monitor performance of revenue-raising measures already in place, MFED will produce annual reports reviewing revenue collections from the VAT and fishing license revenues.
	<b>Policy Action 2.2:</b> MFMRD and the MFED shall have jointly produced a report on sources of fisheries revenue in 2013 containing disaggregated data for fisheries license revenue from agreements with the European Union, the United States of America and from other sources.  <i>(A copy of the report, certified by the Secretaries of MFED and MFMRD)</i>	Capacity building efforts will also be pursued to enhance efficiency in the administration and collection of the newly-installed VAT system.
<b>Output 3: Improved management of public assets and liabilities</b>	<b>Policy Action 3.1:</b> MFED shall have appointed a staff whose principal role is to enforce the implementation of the Debt Policy as approved by Cabinet in 2013.	Government, or SOEs, should not incur any new non-concessional debt with MFED's consistent implementation of the debt

	<p><b><i>(Copy of the Debt Policy, certified by the Cabinet Secretary, job description of the staff, and letter from the Secretary of the MFED certifying that the staff was appointed).</i></b></p>	<p>policy.</p>
	<p><b>Policy Action 3.2:</b> Cabinet shall have approved RERF management policies including: (i) reallocation of RERF assets to achieve consistency with clearly-stated investment objectives; (ii) application of new concentration and deviation limits; and (iii) application of more appropriate benchmarks to improve monitoring of asset manager performance.</p> <p><b><i>(Copy of the Cabinet paper on improving management of the RERF and excerpt from Cabinet minutes, certified by the Cabinet Secretary)</i></b></p>	<p>RERF investment strategy and management reforms will be fully implemented, which should result in stronger performance of its investment portfolio. Any future surpluses from windfall fishing license revenues will also be injected into the RERF to help stabilize its balance.</p>
<p><b>Output 4: Improved structural reform implementation</b></p>	<p><b>Policy Action 4.1:</b> Cabinet shall have agreed to a comprehensive review of shipping to the outer islands aimed at improved services for the sector and approved that contracting out management of the landing craft owned by the government be included as part of the reform process.</p> <p><b><i>(Excerpt from the Cabinet minutes, certified by the Cabinet Secretary)</i></b></p> <p><b>Policy Action 4.2:</b> Cabinet shall have approved the (i) appointment of a liquidator for Bobotin Kiribati Limited and (ii) preparation of a detailed implementation plan and timetable with the recommendations to limit the Government Plant and Vehicle Unit commercial activities to the provision and maintenance of heavy plant and equipment and vehicles for government use and cease activities that are not related to government functions.</p> <p><b><i>(Excerpt from the Cabinet minutes, certified by the Cabinet Secretary)</i></b></p> <p><b>Policy Action 4.3:</b> Cabinet shall have approved an invitation for expressions of interest for private firms to enter into a public-private partnership concession</p>	<p>Recognizing the private sector’s willingness to take on new business opportunities (as reflected by recent experience in SOE reform), government—through the SOE Monitoring Unit—will continue to implement the SOE Act 2013 and SOE Reform Roadmap to identify sectors for further reform and private sector participation.</p> <p>This will be in parallel with implementation of the private sector development strategy.</p>



	<p>agreement with Betio Shipyard Limited.</p> <p><b><i>(Copy of invitation for expressions of interest, and excerpt from Cabinet minutes, each certified by the Cabinet Secretary)</i></b></p>	
	<p><b>Policy Action 4.4:</b> Key provisions of the SOE Act are implemented, including:</p> <p><b>Policy Action 4.4(a):</b> The Government's SOE Monitoring Unit shall have received 2014 SOIs for all SOEs. The SOIs should specify each SOE's (i) main objectives, (ii) projected annual cash flow (iii) projected annual balance sheet and (iv) projected annual profits.</p> <p><b><i>(Copies of the SOIs, and letter from the Secretary of MFED certifying that the SOIs have been approved by the SOE Monitoring Unit)</i></b></p> <p><b>Policy Action 4.4(b):</b> The five largest SOEs—Kiribati Oil Limited, Kiribati Housing Authority, Public Utility Board, Broadcasting and Publications Authority and Air Kiribati Limited—shall have submitted 2013 financial accounts to the Office of the Auditor General for auditing.</p> <p><b><i>(Letter from the Office of the Auditor General certifying that these have been received)</i></b></p> <p><b>Policy Action 4.4(c):</b> All appointments to SOE boards (except appointments of the advisory committee of Plants and Vehicle Unit) shall comply with the SOE Act 2013.</p> <p><b><i>(Copy of the SOE Act, and letter from the Secretary of MFED certifying that the appointment process complied with the SOE Act)</i></b></p>	

CSO = community service obligation, MFED = Ministry of Finance and Economic Development, MFMRD = Ministry of Fisheries and Marine Resources Development, RERF = Revenue Equalization Reserve Fund, SOE = state-owned enterprise, SOI = statement of intent, VAT = value-added tax.